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Brief of Powell for P. in E.

OFFICE SUPREME COURT U.S.
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JAMES H. McKENNEY

SUPREME COURT OF THE UNITED STATES.

[October Term, 1899.]

Filed April 20. 14, 1900.

JOHN JOYCE,

PLAINTIFF IN ERROR.

vs.

H. F. AUTEN, SUCCESSOR OF STERLING R. COCKRILL, AS RECEIVER OF THE FIRST NATIONAL BANK OF LITTLE ROCK, ARKANSAS,

DEFENDANT IN ERROR.

In Error to the United States Circuit Court of Appeals for the Sixth Circuit.

Brief of Plaintiff in Error.

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[No. 329.]

IN ERROR TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT.

BRIEF OF PLAINTIFF IN ERROR.

In the original petition filed in the Circuit Court, the plaintiff declared upon a promissory note executed by James E. Joyce & Company as principals and John Joyce, the plaintiff in error here, as surety. The note was dated at Little Rock, Arkansas, March 20, 1893, payable to C. H. Whittemore, as receiver of The McCarthy & Joyce Company for the sum of $9000.00, due three years after date, with interest at six per cent.

There was embodied in the note the following declaration;

"This is one of the three notes executed for purchase money of the assets of The McCarthy and Joyce Company, this day sold to James E. Joyce & Company."

To this petition John Joyce, as surety, filed an answer setting out two separate defenses. A general demurrer filed to both defenses was sustained by the Circuit Court. Thereupon John Joyce, by leave, filed an amended answer, and to both defenses set out therein a general demurrer was again filed, and likewise sustained by that court, and judgment entered against John Joyce for $11,006.75, the full amount due upon the note.

The action of the Circuit Court in sustaining the demurrers was assigned for error in the Circuit Court of Appeals for said District and upon hearing there the judgment of the Circuit Court was affirmed.

The plaintiff in error claims here that these demurrers should not have been sustained, but should have been overruled and that there is error in the judgments of both courts below.

In the first defense set out in the answer of John Joyce to the petition filed against him he declared that James E. Joyce & Company were the principals upon the said note and that he signed the same only as surety for said James E. Joyce & Company and without any other consideration. He further declared that the note was given as one of the deferred payments for the purchase price of a large number of tracts of land in Little Rock, Arkansas, belonging to the insolvent firm of The McCarthy and Joyce Company. That said property was sold by a receiver by virtue of an order of the Chancery Court at Little Rock. That in the order of sale the receiver was directed to reserve a lien upon the real estate sold to secure the deferred payments and that he was also directed in addition to such reserved lien upon the real estate to take further security by personal endorsements.

The real estate was purchased at such sale from the receiver by James E. Joyce & Company, as declared in the note sued upon, and a very large portion of the purchase money was paid in cash. The defendant, John Joyce, knowing these facts, and that a lien upon the real estate sold would be sufficient to secure the deferred payments, consented to sign the note set out in the petition as surety for the said James E. Joyce & Company. He declared further that the statutes of Arkansas expressly provide that a lien upon real estate sold may be reserved in the deed of conveyance by reciting the fact that the property has not been paid for and reserving a lien for the purchase money. He further states that, knowing such a lien would be ample protection to him in the premises he signed the note upon the express agreement and understanding that the said lien should be reserved and the order of the court in the premises faithfully complied with and performed. He further declares that after receiving said note, and without his knowledge or consent, the receiver neglected and failed to reserve a lien for the purchase money upon the lands sold, as directed by the court, and conveyed all the real estate so sold to the said James E. Joyce & Company, free from any lien thereon, and that the said James E. Joyce & Company, since receiving the said conveyance, sold and conveyed the lands to third parties who were ignorant of the facts, and the lien which should have been preserved has become lost.

He further avers that said property was sufficient in value to have fully paid said note and that the First National Bank of Little Rock, Arkansas, as well as its receiver, who was the plaintiff below, received the said note with full notice of all the facts set out in said answer, and he therefore claimed that he was discharged and released from said note.

POINTS AND ARGUMENT.

I.

The statutes of Arkansas expressly provide that a lien upon real estate may be reserved in the deed of conveyance by reciting the fact that the property has not been paid for, and reserving a lien for the purchase money.

Section 474 of the Revised Statutes of Arkansas provides:

"A lien or equity held or possessed by the vendor of real estate, when the same is expressed upon or appears upon the face of the deed of conveyance, shall inure to the benefit of the assignee of the note, or obligation given for the purchase of such real estate, and may be enforced by such assignee."

This section of the statutes of Arkansas has frequently been passed upon by the Supreme Court of that state. In numerous decisions the Supreme Court of Arkansas has held that when such a lien is expressed upon the face of the conveyance it operates to secure the purchase money the same as if a mortgage had been given.

In the case of *Stroud vs. Pace and Allison*, 35 Arkansas, 100, it is said: "The purchaser of real estate is bound to take notice of all stipulations contained in the chain of title through which he derives title, and to fully investigate and explore everything to which his attention is thereby directed, and if any of such conveyances contain notices that the land has been sold on a credit, he is bound to inform himself as to whether the purchase money has been paid."

In the case of *Shepherd vs. Thomas*, 26 Arkansas, 628, it is held: "Where a vendor stipulates for a lien to secure the purchase price and gives proper notice to all who may be concerned, such lien then becomes a security of such purchase, and may be enforced by the vendor, or he may assign

it to another, and such holder may enforce it, and all being notified that the purchase money remains due and unpaid, justice and equity requires it shall be paid and all subsequent contractors must stipulate to meet such equities."

In other words, the reservation upon the face of a conveyance operates to secure the purchase price of real estate for all persons and against all persons, exactly as if a mortgage had been taken. The order of the court, therefore, to the receiver in this case, to reserve a lien upon the property sold, was to reserve a lien which would be good for all persons and against all persons claiming an interest in the property. In other words, it is a mortgage incorporated in the deed of conveyance.

II.

In determining the rights of the surety in this case under the allegations of his answer, we claim the following principles are elementary:

1. The surety is entitled to the benefit of all the securities in the hands of the creditor and if any be lost by his wilful neglect or want of due diligence, the surety is, to that extent, discharged.

2. If the surety signs the obligation upon the understanding that certain conditions shall be performed, and the creditor knows these conditions, the surety will not be bound if the conditions are not complied with.

3. A surety is released when the creditor parts with a lien for the payment of the principal debt, to which the surety has the right of subrogation.

4. A rule never to be lost sight of in determining the liability of a surety is that he is a favorite of the law and has a right to stand upon the strict terms of his obligation when such terms are ascertained.

5. If through the neglect of the creditor a security to the benefit of which the surety is entitled is lost or not properly perfected, the surety is discharged to the extent that he is injured thereby.

In the case of *Hickock vs. Farmers' Bank*, 35 Vermont, 476, it was held that where a surety signed a promissory note upon the payee promising that as soon as the note became due he would immediately proceed against the principal, the note became due and for over a year the payee failed to sue the principal or notify the surety, and the principal became insolvent. The Court held that the surety was discharged.

In *Jones vs. Kerr*, 30 Georgia, 93, the creditor promised, as an inducement for the sureties to sign the note, that he would assign a judgment and execution which he had against the principal. Instead of doing so he brought suit upon the note. The court held that the sureties were discharged.

Brandt on Suretyship and Guaranty, Section 440, states the rule as follows:

"The creditor who has effects of the principal in his hands or under his control for the security of the debt is a trustee for all parties concerned and if said effects are lost through the negligence or want of ordinary diligence of the creditor the surety is discharged to the extent that he is injured, the same as if the effects had been lost by the positive act of the creditor."

In the case of *Burr vs Boyer*, Second Nebraska, 265, it is held:

"A surety will be discharged by the neglect of the creditor to have a chattel mortgage recorded, made to him by the debtor to secure the debt, if such neglect occasion a loss of the security; but the creditor is not bound to enforce by action securities which he may have taken from the debtor."

In the case of *Law vs. The East India Company*, 4th Vesey, 824, it is said:

"Any act of the obligee that may injure a surety is laid hold of in his favor."

In the case of the *City Bank vs. Young*, 43d New Hampshire, 457, it was held:

"When a creditor disposes of personal property mortgaged to him by the principal as collateral security, he is responsible to the surety for ordinary care and prudence in the sale and the application of the proceeds."

In *Wolff & Billings vs. Jay*, 7 Queen's Bench, 756, it was decided:

"As a surety, on payment of the debt, is entitled to all the securities of the creditor, whether he is aware of their existence or not, even though they were given after the contract of suretyship; if the creditor who has had or ought to have had them in his full possession or power, loses them or permits them to get in possession of the debtor, or does not make them effectual by giving proper notice, the surety, to the extent of such security, will be discharged. A surety, moreover, will be released if the creditor, by reason of what he has done, cannot, on payment by the surety, give him the securities in exactly the same condition as they formerly stood in his hands," and numerous cases are cited in support of this statement.

In the case of *Gillespie vs. Darwin*, 6th Heiskell, 21, it is said:

"In equity it is well settled that a surety is entitled to the benefit of all securities which the creditor obtains against the principal debtor, and if the creditor who has had, *or ought to have had*, them in his full possession or power loses them, or permits them to get into the possession of the debtor,

the surety will, to the extent of such security, be discharged."

In the case of *Watts vs. Shuttleworth*, 5 Hurtstone and Norman, 235, H, by articles of agreement, agreed with W, (plaintiff) to complete certain fittings for a warehouse for £3450. The contract contained a stipulation that W "shall and may insure the fittings from risk by fire at such time and for such amount as the architects may consider necessary." The defendant agreed with the plaintiff to guarantee the due performance of the work by H. The plaintiff advanced £1800 to H, after which the fittings were destroyed by fire. He became insolvent and never repaid the £1800 to the plaintiff or any part of it.

Held: That the plaintiff ought to have insured the fittings, and having omitted to do that which his duty toward the defendant required him to do, and which if he had done, the defendant would have been relieved to the extent of the insurance, the defendant was discharged.

This case was afterwards affirmed in the Exchequer Chamber.

In the 14th American Reports, 389, the defendant signed a bond as surety on condition that the principal would also procure the signature of S—— as surety thereto. In a suit on the bond by the obligee, it was held that the bond was void as to the defendant.

Theobald, in his work on the law of Principal and Surety, declares the rule to be that "if the creditor parts with securities or any fund which he would be entitled to apply in discharge of his debt, the surety becomes exonerated at least to the extent of the value of such securities because securities which the creditor is entitled to apply in discharge of his debt he is bound so to apply, or to hold them as trustee ready to be applied should the surety desire it.

Cooper vs. Joel, De Gex, 240. Upon the eve of a sale by a sheriff a surety gave a written guarantee for the payment of the judgment debts by installments, in consideration of the judgment creditors consenting to postpone the sale under execution. It turned out that the consent of another person was necessary to prevent the sale and in consequence the sale took place. The surety gave notice that the consideration had failed and the guarantee was at an end. It appeared that representations were made in behalf of the judgment creditors when they took the guarantee that they had power to stop the sale and that it would be stopped. Held, that the surety was entitled to have the guarantee delivered up to be canceled.

The demurrer to the answer in this case admits the facts which entitle the surety to the protection of the above well recognized rules of law.

1. John Joyce signed the note upon the understanding and agreement that the lien upon the real estate sold should be reserved and the creditor knew of this condition, but with such knowledge he neglected and refused to comply with the conditions.

2. The creditor had in his possession property which would have been ample protection to the surety, and by the creditor's wilful neglect the surety lost the benefit of such security.

3. The order of court which directed the sale of this property also directed the Receiver to reserve a lien upon the property sold. He knew Joyce became surety upon the understanding that this order would be complied with. This lien, which would have been ample protection for the surety, was lost through the negligence of the creditor.

The judgment of the Circuit Court of Appeals is largely based upon the proposition that the receiver had no notice that Joyce had signed upon the conditions named.

In order to reach this conclusion the court must have overlooked the closing allegation of the first defense in Joyce's

amended answer, which is as follows: "This defendant says that the said The First National Bank of Little Rock, Arkansas, as well as its receiver, *the plaintiff herein, received the said note with notice of all the foregoing facts*, and said note was transferred to the plaintiff herein without any consideration being paid therefor, but for the sole purpose of transferring the said note to the plaintiff as successor in interest of the former receiver of The First National Bank of Little Rock."

Again, in order to reach the conclusion arrived at by the Circuit Court of Appeals, they were compelled to deny facts admitted upon the record.

In the opinion of the court which appears upon the record (folio 28) appears the following statement: "It is incredible that the receiver would have accepted the note subject to such conditions, or if he did, that he would have conveyed the property without reserving the lien." The answer of Joyce clearly alleges that the receiver did the very act which the Circuit Court of Appeals says is incredible, and the demurrer to this answer admits the allegation to be true.

The Circuit Court of Appeals again places great weight upon the claim that it was the duty of the surety to notify the receiver that he had signed upon this condition, and his liability is based upon the alleged negligence of the surety in failing to give this notice and in failing to see that the receiver did reserve the lein directed by the court.

The court here overlooks the fact that the receiver did have notice of this condition, and therefore why should the surety a second time give him notice of a fact of which he already had knowledge?

We also think that as the order of sale expressly directed the receiver to reserve this lein, he was bound to do so and in law he was bound to know that the surety upon the note was

signing upon the full faith that the order of the court would be complied with. We do not think that anyone can be charged with negligence in placing faith and credit in an order of court and that an officer of the court will faithfully execute such order. It must be remembered in this case that the receiver who is charged with negligence was not a stranger to the record. He was a party to the case and the same order which gave him authority to sell also directed him to reserve a lien.

But, in addition to this, we have the fact averred in the answer that the Bank of Little Rock was a party to the proceedings and to the order of sale and that the bank, as well as its receiver, had knowledge of all the facts averred upon which the surety claims a discharge.

Finally, the Circuit Court of Appeals seems to place its decision upon the ground that the creditors of The McCarthy & Joyce Company will suffer loss. In the opinion (folio 28) appears the following language: "Admit that he (meaning the receiver) failed in the discharge of this official duty. Can the surety obtain any benefit therefrom? If so, it will be at the expense of the creditors, who, having lost one surety through the negligence of the receiver, will be deprived of the benefit of another which he did take. Yet the negligence of the creditors thus to be punished does not equal that of the surety who seeks to make it available for his own release."

The court here assumes that the surety was guilty of negligence. No such fact appears upon the record. On the contrary due diligence on his part appears.

Again, the creditors will not suffer loss by the discharge of the surety. The receiver and his bondsmen would be liable to the creditors for all injury they may have sustained by reason of the wilful negligence and default of the receiver.

The Circuit Court of Appeals again make the declaration: "He (meaning the surety) either delivered the note himself or suffered his principals to deliver it to the receiver without notice that his liability was to depend upon the reservation of this lien."

This statement, we claim, is a clear mistake, because it is distinctly averred in Joyce's answer that the receiver did have notice of the condition the failure to comply with which the surety says operated in law to discharge him. A careful comparison of the opinion of the Circuit Court of Appeals with the first defense of Joyce's answer will show that the court arrived at the conclusion laid down in the opinion by directly contraverting facts which are admitted upon the record.

It appears from the above statements that the court must have reached its opinion by overlooking important allegations in defendant's answer and if the admitted facts had been kept in mind by the court a different conclusion would have been reached.

The rule applying to such cases is well stated in Section 445, 2d Brandt on Suretyship: "It is true the books speak of the creditor being under no obligation to exercise active diligence for the protection of the surety as long as the surety himself remains inactive, and that to discharge the surety the creditor must be guilty of some wrongful act, as by a release or fraudulent surrender of the pledge.

"The cases holding this doctrine are mostly cases which decide that the creditor is not bound to enforce and realize upon securities held by him before proceeding against the surety. But it is one thing to convert the securities given by the debtor into money, that they may be applied to satisfy the debt of the principal debtor, and quite another to preserve such securities that they may be made so available. While

the creditor may be relieved from the former, he should be held responsible for the loss of any security arising from his wrongful acts, *either of omission or commission*. Can he who has taken the security stop short and omit to do that which renders it chiefly valuable under the excuse that others did not urge him to file it?"

In *Toomer vs. Dickerson*, 37, Ga., 428, the court said:

"An act of omission on the part of the creditor when the law requires him to act may be quite as potent for mischief to the surety as an act of commission."

In the case of *Teaff vs. Ross*, 1 O. S., 469, Thurman, Justice, said:

"Nor can it be gainsaid that where the creditor who has the securities, suffers them by his laches to become valueless, he is in no better condition than if he had released that security."

In the case at bar the Circuit Court of Appeals held that if the receiver had taken the lien and afterwards released it, the surety would be discharged. Is there any difference between releasing a lien and failing to take one which the law and the order of court under which the receiver acted required him to take? We submit there is no difference between the two cases.

Capell vs. Butler, 2 Sim. & Stu., 457, is a leading case. In this case A became surety for B on a bond conditioned for the payment of an annuity to C. Various securities for the annuity were put up by B, and among them he assigned two ships to C. The assignment was not recorded as required by the ship registry acts, and B afterwards sold the ships and became insolvent, and the ships were lost as security.

Held: That C, by his neglect to record the assignment discharged A to the extent of the value of the ships.

In *City Bank vs. Young*, 43 N. H., 457, it was said:

"Between this class of cases, namely the release of securities by the direct act of the creditor, and allowing them by want of ordinary care to be lost, we are unable to perceive any solid distinction. In both cases the surety may have been lulled into security and prevented from taking the counter security he otherwise would."

The above propositions can be sustained by an almost unlimited number of citations. We will, however, in addition to the above, content ourselves with citing in this connection the following authorities:

Schrock vs Miller, 10 Penna. St., 401.
Holt vs. Brody, 18 Pa. St., 207.
Cummings vs. Little, 45 Maine, 187.
Baker vs Briggs, 19 American Decisions, 311.
Moore vs Gray, 26 O. S., 525.

III.

We also claim that the courts below erred in sustaining the demurrer to the second defense set out in the answers of John Joyce. This second defense declares that at the time of the sale The First National Bank of Little Rock had possession of some sixteen promissory notes, amounting in the aggregate to about $11,000. A full list of the notes, with the names of the makers, the dates thereof, and the time of maturity are fully set forth in said defense.

Mr. Joyce further claimed that these notes were included in the inventory and in the order of sale and that they were purchased by The McCarthy & Joyce Company at the receiver's sale, and that the purchase of said notes constituted a part of the consideration for which the note sued on herein was given. He further says that he signed the note herein described as surety upon the understanding and faith that the

said receiver would deliver to the principals on said note the promissory notes described in said defense.

He further claims that the said notes were sufficient in value to more than pay the note in controversy in this case. He further declares that the said James E. Joyce & Company paid in cash at the time of such purchase the sum of $10,200, and afterwards paid the sum of $10,000 more in cash, and that the notes described in the second defense which were sold and were to be delivered to The McCarthy & Joyce Company were sufficient in value to have paid the balance of the entire purchase money, and that the receiver of The First National Bank and his successors in interest have wrongfully refused to deliver said notes, although often requested so to do by the said James E. Joyce & Company and as they were required to do by the terms of said sale.

We submit that this second defense constitutes a complete defense of failure of consideration.

In order to sustain the demurrer to this part of the answer it was necessary for the court below to find that The First National Bank of Little Rock must have held the notes as security for some claim of the bank and that the bank must have had a banker's lien upon the notes. There is nothing in the record to justify such an assumption. On the contrary, it appears from the answer and the demurrer thereto that there was no such claim and that the Bank at Little Rock did not have any lien, banker's or otherwise, upon said notes.

It was claimed by counsel on the other side that it was impossible to separate these notes from the other properties sold and conveyed. The rule of law as we understand it is that a partial failure of consideration is a good defense *pro tanto*, provided such part as is alleged to have failed is separate, distinct and definite, or the failure of a specific and ascertained part can be shown by way of defense. In this case the notes in controversy were separate and distinct property from the

real estate sold, and it presents a case of the failure of a specific and ascertained part of the property which was sold.

In other words, these notes were all the notes which were included in the sale and they were separate and distinct property from the other assets which were sold at that time. We claim, therefore, that the property was distinct and definite and that the partial failure which relates to the non delivery of these notes is as good a defense *pro tanto* as if there had been an entire failure of the entire consideration of the notes.

As these notes, if turned over to the principal, were sufficient in value to have placed in their hands sufficient property to have entirely paid the note in controversy, our claim is that by the wrongful withholding of them from the purchasers the consideration of the note in controversy has failed and that John Joyce as surety thereon is discharged from his obligation.

We therefore submit that there are errors appearing in the record in the judgments of both courts below, and we therefore ask that the said judgments may be reversed and the cause remanded. Respectfully submitted,

By THOMAS E. POWELL &
THOMAS B. MINAHAN,
Counsel for Plaintiff in Error.